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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 003478

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TAGS: [EFIN](#) [ECON](#) [PREL](#) [EPET](#) [EINV](#) [IZ](#) [KU](#)
SUBJECT: FALLING OIL PRICES FORCE TOUGH IRAQI BUDGET
DECISIONS

REF: A. BAGHDAD 2944
 [B.](#) BAGHDAD 3364
 [C.](#) BAGHDAD 3417

Classified By: Economic Minister Counselor Marc Wall for reasons 1.4(b)
and (d)

[11.](#) (C/NF) Summary: Given the sharp fall in the price of oil and declining exports, Iraq's budget situation had radically changed and cuts would be made to both Iraq's FY 2009 capital expenditures and operating costs, according to Minister of Finance Bayan Jabr in an October 27 meeting with EMIN. Given that the bulk of GoI operating costs are salaries, and salary increases were just put into effect in 2008, most of the budget cuts will fall on the capital budget. The revised budget baseline would emerge from talks with the IMF later in the week, said Jabr. While funds to pay the Kuwait Airlines debt had been in the initial budget proposal, Jabr was not sure it would be in the final budget sent by the Council of Ministers to the Council of Representatives. The GOI was waiting for the Kuwaiti Prime Minister to visit Iraq before reengaging on bilateral debt issues. End summary.

[12.](#) (SBU) EMIN and Treasatt discussed the upcoming USG-GOI Dialogue on Business and Investment Climate, Kuwaiti debt issues, and Iraqi budget problems with Minister of Finance Bayan Jabr on October 27. Jabr opened the meeting by discussing how interested Iraqi media was in the effects of the international financial crisis on Iraq. Jabr believes that the only effect on Iraq will be the impact falling oil prices has on Iraq's budget process.

Debt Issues: Waiting on Kuwait

[13.](#) (C) In response to a question about any developments on debt issues with Kuwait, Jabr responded that there was "nothing new with Kuwait." The Iraqis were waiting for the promised, but not yet planned, Kuwaiti Prime Minister visit to Iraq. Jabr noted that there had been funds in the original 2009 budget to pay for the Kuwait Air claim (ref A). However, given the budget upheaval Iraq has faced with the sharp decline in oil prices, he was no longer certain that such funds would be in the final budget.

[14.](#) (C) Returning to a theme he raised in September (ref A), Jabr noted that Kuwait and Iraq "should be" natural allies in this region due to the fact that they are: (1) both friends of the United States, (2) neighbors, and (3) Iraqis owe a debt to the Kuwaitis for allowing the United States to liberate Iraq through Kuwait. Without the help of the Kuwaitis, he said, "we would still be in opposition and Saddam would still be in power." "Illiterates and peasants" believe that there is a natural enmity between Iraq and Kuwait due to propaganda "during the Saddam time" that Kuwait was the 19th Province of Iraq. Actions by the Kuwaitis such as placing liens on Iraqi aircraft only feed this mindset in Iraq. The Kuwaitis should be "careful not to take advantage

of Iraq's weakness now. They need to look to the future when Iraq will be strong again," he warned and asked that this message be passed by the USG to the Kuwaiti Government.

Upcoming Dialogue on Business and Investment Climate

¶ 16. (C) Noting that he was pleased that the upcoming U.S.-Iraq Dialogue on Business and Investment Climate was being held in Baghdad, Jabr said that "it is a very positive sign" that Treasury Deputy Secretary Kimmitt is coming and bringing U.S. investors with him (ref B). "It is very important for American companies to come and invest in Iraq. They should not wait while investments are being made with companies from other countries. If they are concerned about the security here, they should enter into joint ventures with Iraqis." He observed that the recently established correspondent relationship between Citibank and Iraq's Al Warka Bank is an "excellent development." (ref C)

Budget Woes: Falling Oil Prices, Declining Production

¶ 17. (C) Jabr said that the FY 2009 Iraqi budget process had begun when oil was at USD 150 per barrel and Iraq was exporting about 2 million barrels per day (bpd). However given the fall in oil prices and Iraq's declining oil exports, Jabr said that Iraq's budget assumptions at the moment called for exports of 1.7 million bpd and a price of USD 50 per barrel. (Note: This amounts to revenue of roughly

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USD 31 billion about half the USD 61 billion in the original FY 2009 budget projections. End note.) Jabr is traveling to Amman, Jordan for budget discussions with the IMF on October 30 and said that the outcome of these meetings will determine the size and shape of Iraq's FY 2009 budget.

¶ 18. (C) "The price of oil is not the real problem," said Jabr. "The real problem is the fact that our oil production is falling." "If we could produce more, it would not matter what the price was," he emphasized. Jabr blames falling oil production on "technocratic oil ministers" who have wasted five years trying to fix the problems themselves, he said, "they should have allowed private companies to solve their problems; government cannot."

Cutting Capital Expenditures Easier than Salaries

¶ 19. (C) Jabr prefaced his remarks on the current state of FY 2009 budget negotiations in the Council of Ministers by stating that "Operating expenses cannot be reduced, only the investment budget will be affected." The USD 60 billion operating budget is "politically difficult" to cut given that the majority of this budget is used for salaries. That being said, he had identified about USD 3-4 billion in cuts that he could make from the operating budget: USD 1 billion from salary increases for state owned enterprise employees since "they are not real civil servants and don't do that much work;" USD 1-1.5 billion in a "civil service salary surplus fund" to hire new government workers, meaning that the budget would allow for an increase of only roughly 30,000 new employees, not the original 140,000; and roughly USD 1 billion from reducing provincial capital expenditure (investment) budgets from the original USD 6 billion to USD 5 billion. Jabr added that it was also likely that USD 500 million could be cut from the Public Distribution System budget given the fall in food prices on the international market. Jabr was not concerned about cutting provincial budgets since they have money left over from previous budget years that they have not yet spent.

¶10. (C) Jabr said that he intended to cut FY 2009's ministerial investment budgets, or capital expenditures, funds by 20 percent across the board. He anticipated that this would cause consternation amongst the ministers who have become accustomed to Jabr approving every budget request they have placed before him. "I know the ministers will fight me, but this is a tough time so I will be tough," he said smiling. Adding, "We will take painful measures in the next budget to protect the budget of Iraq." That being said, Jabr did not anticipate problems meeting Iraq's capital expenditure needs in 2009.

¶11. (C/NF) Jabr said that there were approximately USD 22 billion in the Development Fund for Iraq (DFI) account at the Federal Reserve Bank of New York, and an additional USD 5 billion of MoF funds on deposit with the CBI (typically, these are held for conversion into Iraqi Dinar), and these could be used to fund any deficit spending in the 2009 budget. Jabr also raised the possibility of selling bonds to the Central Bank of Iraq in order to utilize Central Bank reserves to finance capital expenditures, but such a move could be expected to raise serious objections from the IMF and others.

¶12. (C) In response to a question from Treasatt, Jabr said that he had authorized USD 2 billion for expenditures on Provincial Investment Councils (PICs) in the FY 2008 budget. "This money is available, all they have to do is ask for it."

¶13. (C/NF) Comment: Iraq's failure over the past five years to address its oil production and export infrastructure needs, when coupled with declining oil prices, will have a significant impact how it shapes its 2009 budget. Jabr is prepared to make substantive budget cuts to bridge the gap between revenues and expenses, however the bulk of the cuts will have to occur in Iraq's capital budget at a time when there are pressing needs to continue the rebuilding of the country. Moreover, Jabr indicated that he is prepared to spend from GOI reserves held in the DFI, as well as at the Central Bank. If the situation deteriorates too badly, we may see attempts to utilize the CBI's substantial reserves to finance the budget deficit. However, this would be inconsistent with the CBI statutory independence, and it would undermine the value of the IQD by reducing the reserves that back the currency. We will report septel on Planning Minister Baban's reaction to the likely capital budget cuts.

End comment.

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